TORBAY COUNCIL

Treasury Management Strategy 2024/25

January 2024

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1 Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires Full Council to approve a Treasury Management Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and also complies with CIPFA Prudential Code for Capital Finance in Local Authorities 2021 guidance.

The Strategy for 2024/25 covers:

- Capital expenditure and Prudential Indicators
- the Minimum Revenue Provision (MRP) policy
- forecasts for future interest rates;
- the Borrowing Strategy;
- the Investment Strategy;
- treasury indicators which limit the treasury risk and activities of the Council
- policy on use of external service providers;
- reporting arrangements and management evaluation

2 Capital Expenditure and Prudential Indicators

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators below, which are designed to assist Members' overview.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

A different approach is being taken in respect of setting an approved Capital Investment Programme for 2024/25, whereby various elements of grant funding are being held within a 'Project Pending' list prior to establishing affordable, tangible business cases for each respective project. The proposed 2024/25 capital expenditure of £23m, as at January 2024, only reflects the true costs, and timing, of progressing each project to the next stage, (or gateway), of Council approval which might be Initial feasibility, Outline Business Case, Full Business Case or Final Delivery.

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

£M	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
General Fund services	33	61	23	11	5

It is anticipated that, during the course of the year, these figures will significantly increase as projects work through the gateway process and subsequent approvals granted which will move projects, and funds, from the pending list into the approved Capital Investment Programme. Such changes will be reported in, and approved through, quarterly budget monitoring reports presented to Overview and Scrutiny, Cabinet and Council.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

£M	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
External sources	18	29	18	7	5
Own resources	1	2	1	1	0
Debt	14	30	4	3	0
TOTAL	**33**	**61**	**23**	**11**	**5**

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP is set out in Table 3:

Table 3: MRP for financing debt on maturity in £ millions

£M	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Minimum Revenue Provision	8	8	9	9	9

The Council's full policy on **Minimum Revenue Provision** is set out at Appendix 1

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit, (also termed the authorised limit for external debt), each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Whereas Council borrowing will still be an integral part of delivering much needed capital investment within the Bay, the level of long-term debt, as reported in the 2023/24 Treasury Management Strategy was £385m (almost three times the Council's net annual revenue budget). Therefore, future borrowing requirements have been constructively challenged with any future approvals needing to be supported by robust and realistic revenue streams sufficient to repay the debt and interest incurred.

Table 4: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit
Authorised limit – borrowing Authorised limit – PFI and leases Authorised limit – total external debt	600 20 620	480 20 500	500 20 520	520 20 540
Operational boundary – borrowing Operational boundary – PFI and leases Operational boundary – total external debt	500 20 520	430 20 450	450 20 470	470 20 490

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 5: Prudential Indicator: Proportion of financing costs to net revenue stream

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 estimate	2026/27 estimate
Net Revenue Stream	£122m	£131m	£138m	£143m	£148m
Financing costs (£m)	£18m	£19m	£18m	£18m	£18m
Proportion of net revenue stream	**14.8%**	**14.5%**	**13.0%**	**12.6%**	**12.2%**
Financing costs exclude income from Investment Property portfolio which is included within the Net Revenue.	£(14)m	£(14)m	£(14)m	£(14)m	£(14)m
Percentage of Financing Costs to Net Revenue Stream inc. Investment Property Gross Rental Income	3.3%	3.8%	2.9%	2.8%	2.7%

3 Local Context

In November 2023, the Council repaid circa £19m of long-term debt in order to provide a better balance of the overall level of debt compared with relatively high cash balances held over recent years. As a result, as at 30th November 2023, the Council held £364m of borrowing and £63m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 6 below.

Table 6: Balance sheet summary and forecast:

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
Capital Financing Requirement	**428**	**449**	**444**	**439**	**430**
Less: Other debt liabilities *	(15)	(14)	(13)	(12)	(11)
Loans CFR	**413**	**435**	**431**	**427**	**419**
Less: External borrowing	(385)	(359)	(355)	(349)	(347)
Internal borrowing	**28**	**76**	**76**	**78**	**72**
Less: Usable reserves	(96)	(86)	(76)	(76)	(75)
Less: Working capital and other cash backed balance sheet items	(23)	(46)	(46)	(45)	(47)
Treasury investments	**(91)**	**(56)**	**(46)**	**(43)**	**(50)**

* PFI liabilities that form part of the Council's total debt

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Council's current strategy is to apply its cash resources in place of external borrowing in the short term, i.e. internal borrowing.

The Council has a reducing CFR, due to the finite Capital Plan and ongoing MRP adjustments, which can be funded from internal resources over the medium term thereby delaying the need to borrow.

As part of the 2024/25 budget setting process, the Council has reviewed and revised the affordability and deliverability of its Capital Investment Programme. The updated programme will reduce the overall Capital Financing Requirement and future loans required when the Council's Balance sheet is restated at the end of the 2023/24 financial year.

CIPFA’s *Prudential Code for Capital Finance in Local Authorities* recommends that the Council’s total debt should be lower than its highest forecast CFR over the next three years. Table 6 shows that the Council expects to comply with this recommendation during 2024/25.

Liability benchmark: The Code requires a “liability benchmark” to be calculated showing the lowest risk level of borrowing. This assumes the spend forecasts as detailed in table 1, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain sufficient liquidity but minimise credit risk.

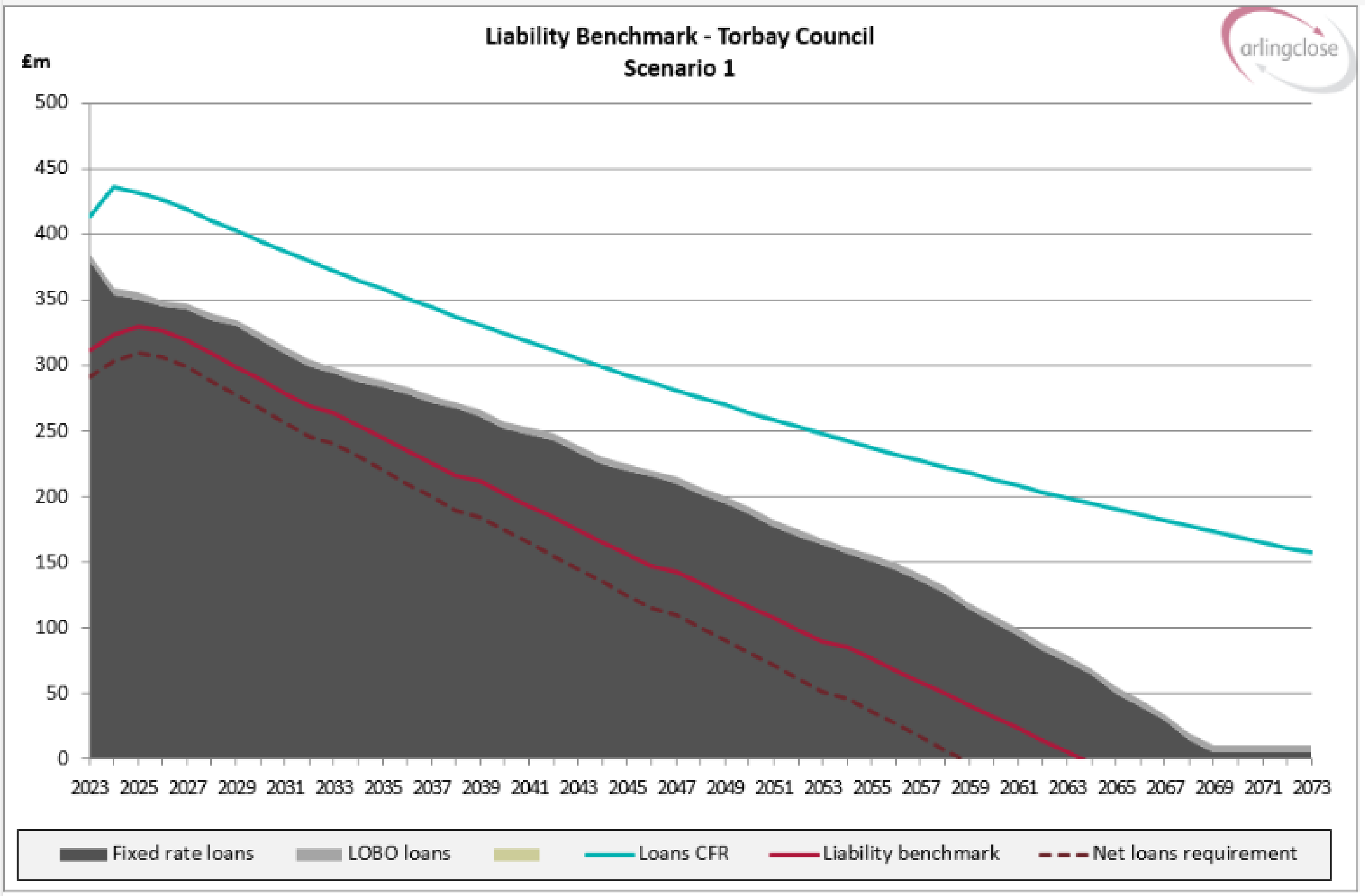
The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

However, consideration will be given regarding the use of cash balances, at a point in time, to fund a long-term borrowing requirement as this could result in risks around higher debt costs when borrowing is required.

Table 7: Prudential Indicator - Liability benchmark

	31.3.23 Actual £m	**31.3.24 Estimate £m**	**31.3.25 Forecast £m**	**31.3.26 Forecast £m**	**31.3.27 Forecast £m**
Loans CFR	413	435	431	427	419
Less: Balance sheet resources	(119)	(132)	(122)	(121)	(122)
Net loans requirement	294	303	309	306	297
Plus: Liquidity allowance	20	20	20	20	20
Liability benchmark	**314**	**323**	**329**	**326**	**317**

The maturity profile of the Council’s existing borrowing compared with the Capital Financing Requirement and ‘Liability Benchmark’ are detailed in the following graph:



Liability Benchmark - Torbay Council
Scenario 1
£m
500
450
400
350
300
250
200
150
100
50
0
2023 2025 2027 2029 2031 2033 2035 2037 2039 2041 2043 2045 2047 2049 2051 2053 2055 2057 2059 2061 2063 2065 2067 2069 2071 2073
Fixed rate loans
LOBO loans
Loans CFR
Liability benchmark
Net loans requirement

4 Economic and Interest Rate Forecast

The Council's advisors, Arlingclose Ltd have provided an economic commentary (updated for November 2023) detailed as Appendix 2 together with their interest rate forecasts for future years as shown in table 8:

Table 8: Arlingclose Ltd interest rates forecast

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	**5.25**	**5.25**	**5.25**	**5.25**	**5.00**	**4.75**	**4.25**	**4.00**	**3.75**	**3.50**	**3.25**	**3.00**	**3.00**
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	**5.40**	**5.40**	**5.40**	**5.30**	**5.15**	**4.80**	**4.30**	**4.10**	**3.80**	**3.50**	**3.25**	**3.05**	**3.05**
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	**4.28**	**4.35**	**4.30**	**4.25**	**4.10**	**4.00**	**3.75**	**3.50**	**3.40**	**3.30**	**3.30**	**3.30**	**3.35**
Downside risk	0.00	-0.55	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	**4.32**	**4.40**	**4.35**	**4.30**	**4.25**	**4.15**	**4.00**	**3.80**	**3.75**	**3.65**	**3.60**	**3.65**	**3.70**
Downside risk	0.00	-0.55	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	**4.78**	**4.70**	**4.65**	**4.55**	**4.45**	**4.35**	**4.25**	**4.25**	**4.25**	**4.25**	**4.25**	**4.25**	**4.25**
Downside risk	0.00	-0.55	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	**4.38**	**4.30**	**4.25**	**4.20**	**4.15**	**4.15**	**4.10**	**4.10**	**4.10**	**4.10**	**4.10**	**4.10**	**4.10**
Downside risk	0.00	-0.55	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

Note: The Council will borrow at PWLB certainty rate which is the relevant gilt yield + 0.80%

Arlingclose have highlighted the following key points:

- Bank Rate has most likely peaked at 5.25%
- The Monetary Policy Committee (MPC) will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering effects. Rate cuts are likely to commence from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate remain on the upside, but these diminish over the next few quarters and shift to the downside before balancing out, due to the weakening UK economy and dampening effects on inflation.
- Gilt yields are likely to eventually fall from current levels, (amid continued volatility), reflecting the lower medium-term path for Bank Rate. However, yields will remain higher than in the past, due to quantitative tightening and significant bond supply.

5 Borrowing Strategy

The Council currently holds £364 million of loans, a decrease of £21 million on the previous year. The balance sheet forecast in table 6 shows that the Council does not expect to need to borrow in 2024/25 due to internal resources being available to fund capital expenditure in the short term. However, should the Capital Plan be expanded, the Council may borrow to pre-fund future years' requirements providing this does not exceed the Authorised Limit for borrowing.

Objectives: The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure, particularly to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when forecasts expect long-term borrowing rates to rise modestly.

In the event of any new external borrowing requirements over and above internal borrowing capacity, the Council will look to the PWLB to secure long-term funding of projects. However, alternative sources will be considered. This approach may also be combined with short- term borrowing to augment the affordability criteria.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

The budget for payment of interest on debt for 2024/25 has been based on an assumed £359m of "historic" borrowing as at 31/03/24 with an overall borrowing rate of 2.91% (2.98% in 2023/24).

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Peninsula Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

- Municipal Investments using loans and bonds
- “Green” bonds (loans to Council)

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits below in section 7 Treasury Management Indicators.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Chief Finance Officer may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years. In response to this the Council repaid circa £19m of long-term loans in November 2023.

6 Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year the Council's investment balance has ranged from a high of £102 million down to around £62 million currently. That current level is likely to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy: As demonstrated by the liability benchmark in Section 2 above, the Council expects to be a long-term investor and treasury investments will therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

To achieve this the Director of Finance is reviewing opportunities for further diversification into strategic investments with the expectation that a proportion of available cash will be placed early in 2024/25 following a robust evaluation process.

The policy for who the Council can invest with, (counterparty selection), and investment limits is detailed in Appendix 3.

Non-Financial Investments Strategy

The Government and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. The current schedule of non-financial investments is detailed at Appendix 4. All decisions have followed the appropriate risk management framework and strategy for non-financial investments as approved by Council.

Any involvement by the Council in community investment schemes such as Credit Unions and Mutual Banks would fall into this category and would not be managed within the treasury management policies.

Guidance within the Prudential Code states that, "councils with existing commercial investments are not required by this Code to sell these investments……however councils that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management strategy. These reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits" The last review was set out in the Treasury Management Strategy 2023/4.

Environmental, Social and Governance (ESG) Investments

Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG considerations do not currently include ESG scoring or other real-time ESG criteria at an individual investment level. Officers will continue to monitor and evaluate ESG investment opportunities, and these may be incorporated into future investment strategies subject to yield and security. Given the limited range of counterparties the Council can use for its investments and that borrowing is mainly from the Government there are limited opportunities to apply ESG principles in this Strategy.

7 Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/credit score of its investment portfolio. The credit score is calculated by applying a value to each investment (AAA=1, AA+=2, …. A=6 etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating (score)	A (6)

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 1 months	£10m

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk.

The Council's debt portfolio is virtually all at fixed rate and therefore has no exposure to fluctuations in interest rates. As such, no specific limits are proposed on interest rate exposure but any new borrowing will be restricted to a maximum **30%** of the total portfolio exposed to variable interest rate.

Maturity structure of borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	50%	0%
20 years and within 30 years	50%	0%
30 years and within 40 years	50%	0%
40 years and above	50%	0%

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	**2023/24**	**2024/25**	**2026/27**
Limit on principal invested beyond year end	£40m	£40m	£40m

8 Treasury Management Consultants

Arlingclose Ltd was appointed as the Council's external Treasury Management advisor for three years from April 2020, following a full tender process. An option to extend the term for a further two years was subsequently exercised by the Council.

The Council recognises that responsibility for Treasury Management decisions always remains with the organisation and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information including, but not solely, our treasury advisers.

9 Reporting Arrangements and Management Evaluation

Members will receive the following reports for 2024/25 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Mid-Year Treasury Management Review report
- Annual Treasury Management Outturn report

The Director of Finance, (CFO), will inform the Cabinet Member for Corporate Services, Finance and Housing of any long-term borrowing or repayment undertaken or any significant events that may affect the Council's treasury management activities. The CFO will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

The Director of Finance is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit. Any such change will be reported to the next meeting of the Council.

The impact of these policies will be reflected as part of the Council's revenue budget and therefore will be reported through the quarterly budget monitoring process.

The Council's management and evaluation arrangements for Treasury Management will be as follows:

- Monthly monitoring report to the Director of Finance (Chief Finance Officer);
- Quarterly monitoring report to the Cabinet Member for Corporate Services, Finance and Housing;
- Quarterly meeting of the Director of Finance, Treasury Manager and Treasury Advisors (Arlingclose) to review previous quarter performance and plan following period activities;
- Ad-hoc meetings with the Council's treasury advisors as required;
- Regular Investment benchmarking against other local authorities

The Audit Committee is the governance body responsible for the scrutiny of Treasury Management, making any relevant recommendations and amendments through Cabinet and Full Council.

The CIPFA Code requires the Chief Finance Officer to ensure that members with responsibility for treasury management receive adequate training. In compliance with this, a comprehensive briefing, and training event, was held on 6th December 2023, delivered by Arlingclose and the Director of Finance.

The training needs of treasury management officers are periodically reviewed.

Appendix 1

Policy on Minimum Revenue Provision for 2024/25

The Minimum Revenue Provision is a statutory charge that the Council is required to make from its revenue budget. This provision enables the Council to generate cash resources for the repayment of borrowing.

The basis for the calculation of the provision is prescribed by legislation (Local Authorities (Capital Finance and Accounting (England) (Amendment)) Regulations 2012 and supported by statutory guidance, which states that Councils are required to "determine for the current financial year an amount of MRP that it considers to be prudent" and prepare an annual statement on their MRP calculation to their Full Council.

One of the aims of this legislation is to ensure that the repayment of principal owed for Capital expenditure is charged on a prudent basis. Central Government guidance says:

> "*the broad aim of prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the Capital expenditure provides benefits"*

For Supported Borrowing, (borrowing funded by central government), the Council will charge MRP at 2% of the balance after deduction of the value of Adjustment A (a set valuation in 2004), to clear the borrowing liability over a period of 50 years.

In relation to transferred debt from Devon County Council the Council deem it prudent to allocate a VRP, (voluntary revenue provision), calculated in line with the supported borrowing calculation, based on a total repayment period of 50 years.

For capital expenditure funded from unsupported borrowing the Council will make a MRP based on the cumulative expenditure incurred on each asset, (including investment fund properties), in the previous financial years using a prudent asset life, which reflects the estimated usable life of that asset.

The MRP for each asset will be calculated on the asset life method using an annuity calculation. MRP will be calculated on the total expenditure on that asset, in the financial year **after the asset becomes operational** or 12 months after operational or when there is an income stream in relation to that asset.

The Council will continue to charge services for their use of unsupported borrowing using a prudent asset life (or a shorter period) on an annuity calculation. Where possible the same asset life and borrowing interest rate will be used for both the charge to services and the calculation of the MRP.

To mitigate any negative impact from the changes in accounting for leases and PFI schemes the Council will include in the annual MRP charge an amount equal to the amount that has been taken to the balance sheet to reduce the balance sheet liability for a PFI scheme or a finance lease. The calculation will be based on the annuity method using the Internal Rate of Return (IRR) implicit in the PFI or lease agreement.

Where loans are given for capital purposes, they come within the scope of the prudential controls established by the Local Government Act 2003 and the Local Authorities (Finance and Accounting) (England) Regulations 2008.

The Capital Financing Requirement (CFR) will increase by the amount of the loan. Once the funds are returned to the local authority, the returned funds are classed as a capital receipt with those receipts being earmarked specifically to that loan, and the CFR and loan will reduce accordingly. If the expectation is that funds will be repaid in full at some point in the future, there is no requirement to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position of each loan will be reviewed on an annual basis by the Chief Finance Officer.

Where relevant, the suggested asset lives for certain types of capitalised expenditure as detailed in the MRP statutory guidance issued by DLUCH will be used. The latest guidance issued in March 2018 suggests a maximum asset life of 50 years.

In terms of **Council led Housing developments**, the MRP charge can be based on the life of the housing assets developed. A life of more than 50 years can be applied if supported by an independent valuer’s report.

Each asset life will be considered in relation to the asset being constructed (primarily to ensure the MRP period does not exceed asset life); however, as a guide the following are typical ranges for asset lives that will be used.

Asset Type	Range of Asset Life
Freehold Land (speciifed in DCLG statutory gudiance)	50 years
Buildings	20-40 years
Investment Properties	25-50 years
Software	5-10 years
Vehicles & Equipment	5-8 years
Highway Network	25-40 years
Structural Enhancements	10-25 years
Infrastructure	25-50 years

For capital expenditure where land and buildings are not separately identified a blended asset life can be used.

Appendix 2
Economic Commentary

(Provided by Arlingclose Ltd, November 2023)

Economic background: The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Council's treasury management strategy for 2024/25.

The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level in September and then again in November. Members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with near-term risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

Office for National Statistics (ONS) figures showed CPI inflation was 6.7% in September 2023, unchanged from the previous month but above the 6.6% expected. Core CPI inflation fell to 6.1% from 6.2%, in line with predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling, declining to around 4% by the end of calendar 2023 but taking until early 2025 to reach the 2% target and then falling below target during the second half 2025 and into 2026.

ONS figures showed the UK economy grew by 0.2% between April and June 2023. The BoE forecasts GDP will likely stagnate in Q3 but increase modestly by 0.1% in Q4, a deterioration in the outlook compared to the August MPR. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth remained strong, with regular pay (excluding bonuses) up 7.8% over the period and total pay (including bonuses) up 8.1%. Adjusted for inflation, regular pay was 1.1% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.

Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve paused in September and November, maintaining the Fed Funds rate target at this level. It is likely this level represents the peak in US rates, but central bank policymakers emphasised that any additional tightening would be dependent on the cumulative impact of rate rises to date, together with inflation and developments in the economy and financial markets.

US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But as the impact from higher rates is felt in the coming months, a weakening of economic activity is likely. Annual CPI inflation remained at 3.7% in September after increasing from 3% and 3.2% consecutively in June and July.

Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.9% in October 2023. Economic growth has been weak, and GDP was shown to have contracted by 0.1% in the three months to September 2023. In line with other central banks, the European Central Bank has been increasing rates, taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75%, 4.25% and 4.50% respectively.

Credit outlook: Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

However, the institutions on Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (November 2023): Although UK inflation and wage growth remain elevated, the Authority's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.

Arlingclose expects long-term gilt yields to eventually fall from current levels (amid continued volatility) reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

Like the BoE, the US Federal Reserve and other central banks see persistently high policy rates through 2023 and 2024 as key to dampening domestic inflationary pressure. Bond markets will need to absorb significant new supply, particularly from the US government.

Appendix 3
Creditworthiness Policy and Investment Limits

The Council may invest its surplus funds with any of the counterparty types in table 9, subject to the cash limits, (per counterparty), and the time limits shown. The Chief Finance Officer will exercise his delegated powers "to take any decisions, (including Key Decisions), and to exercise all legal powers relevant to the Council's borrowing, investments and financial management)" (s.7.1 of the Constitution – Officer Scheme of Delegation) to vary these limits at any time to ensure they remain viable and relevant during any market or political volatility.

Table 9: Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	3 years	Unlimited	n/a
Local authorities & other government entities	3 years	£15m	Unlimited
Secured investments *	3 years	£15m	Unlimited
Banks (secured)*	3 years	£15m	Unlimited
Banks (unsecured) *	13 months	£6m	Unlimited
Building societies (unsecured) *	13 months	£6m	£18m
Registered providers (unsecured) *	3 years	£6m	£20m
Money market funds *	n/a	£15m	Unlimited
Strategic pooled funds	n/a	£10m	£30m
Real estate investment trusts	n/a	£10m	£20m
Other investments *	3 years	£6m	£15m

This table should be read in conjunction with the notes below

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government: Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £15,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only new investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

Reputational aspects: The Council is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government or, on an exception basis, with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £86 million on 31st March 2024. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 10: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£30m per manager
Foreign countries	£30m per country